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United States Department of State
and the Broadcasting Board of Governors
Office of Inspector General

Office of Audits

Independent Accountants' Report Agreed-Upon Procedures on Choctaw Archiving Enterprise's Proposed Direct Labor and Indirect Labor Rates and Accounting System

Report Number AUD/CG-06-26, May 2006

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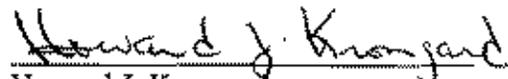
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on Choctaw Archiving Enterprise's
Proposed Direct Labor and Indirect Labor Rates and Accounting System**

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Leonard G. Birnbaum and Company, LLP, Certified Public Accountants, performed agreed-upon procedures under Department of State, Office of Inspector General, Contract No. SAQMPD04D0033, and by acceptance this report becomes a product of the Office of Inspector General.


Howard J. Krongard
Inspector General

5/1/06
Date

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Summary

At the request of the Department of State (Department), Bureau of Administration, Office of Logistics Management, Office of Acquisitions Management (A/LM/AQM), the Office of Inspector General (OIG) contracted with Leonard G. Birnbaum and Company, LLP (LGB) to perform agreed-upon procedures on direct labor hour and indirect expense rates proposed by Choctaw Archiving Enterprise (Choctaw) on November 23, 2005, in response to a Department request for a proposal for an International Maintenance Assistance Program. LGB also reviewed Choctaw's accounting system to determine whether it was adequate to account for federal funds under the proposed contract.

We found that Choctaw's proposed direct labor and indirect costs are excessive. In particular, Choctaw's basic wage rates include a premium charge. Also, proposed annual increases for health care in the base and option years are too high. The results of other items reviewed concerning Choctaw's proposed costs are included in the notes to Schedule A-1 and A-2 attached to this report. In summary, we recommend costs of \$26,119,382, or \$1,985,783 less than the costs proposed by the contractor for the base year and the four option years.

Our review of Choctaw's financial statements disclosed an account structure that does not differentiate between direct and indirect costs. As such, Choctaw's accounting system is not considered adequate for the accumulation of costs under flexibly priced contracts and is minimally adequate to account for federal funds under the proposed contract.

We recommend that A/LM/AQM use our recomputed rates set forth in Schedule A-2 to price delivery orders that Choctaw will perform under the proposed contract. Also, regarding our accounting system review, we recommend that the Department contracting officer's representative periodically review Choctaw's invoiced labor charges based on supporting timesheets and other relevant documents.

Background

Choctaw submitted a proposal to the Department's Bureau of Overseas Buildings Operations (OBO) to provide services under OBO's International Maintenance Assistance Program. Choctaw's proposal contemplates a subcontract being awarded to Garry Struthers Associates, Inc. (Struthers). Struthers was the prime contractor on the predecessor procurement of these services. The proposal is on a fixed rate per direct labor hour basis.

Purpose, Scope, and Methodology

The primary purpose and scope of this agreed-upon procedures engagement was to review Choctaw's proposed direct labor and indirect labor expense rates and Choctaw's accounting system. We performed this agreed-upon procedures engagement in accordance with standards established by the American Institute of Certified Public Accountants and in accordance with *Government Auditing Standards*. The sufficiency of the procedures is solely the responsibility of OIG. Consequently, we make no representation regarding the sufficiency

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of the procedures described below either for the purpose for which OIG requested this report or any other purpose. The procedures we performed are summarized as follows:

1. We reviewed the structure of Choctaw's proposed rates to assess the appropriateness of the cost elements included in the rates.
2. We obtained current actual base labor rates for the majority of the proposed categories of labor.
3. We assessed the reasonableness of the base labor rates for which Choctaw was unable to provide current actual base labor rates.
4. We obtained sufficient supporting documentation or other data to reach a conclusion as to the reasonableness of the amounts proposed for Federal Insurance Contributions Act (FICA), Federal Unemployment Insurance, State Unemployment Insurance, Workers' Compensation Insurance, health and welfare, and uniform maintenance.
5. We obtained and assessed documentation supporting the general and administrative rates proposed by both Choctaw and Struthers.
6. We assessed the adequacy of Choctaw's accounting system for purposes of performing the contemplated contract.

Because the above procedures do not constitute an audit conducted in accordance with generally accepted auditing standards or *Government Auditing Standards*, we do not express an opinion on the adequacy and compliance of the reviewed cost or pricing data. In connection with the procedures referred to above, no matters came to our attention that caused us to believe that there were significant inadequacies or noncompliance related to the areas reviewed. This report relates only to the rates and accounting system specified above.

Agreed-Upon Procedures Results

Direct Labor and Indirect Costs

Choctaw's proposal to provide overseas maintenance assistance to the Department includes excessive costs. Choctaw proposed direct labor and indirect costs of (b) (4)(b) (4) for the proposed contract base year and the four option years. We recommend costs of (b) (4)(b) (4)(b) (4)(b) (4)(b) (4)(b) (4) less than Choctaw proposed. The details of Choctaw's proposed direct labor and indirect costs and our recommended rates are in Schedules A-1 and A-2, respectively.

Choctaw's basic wage rates are 105 percent of the rates currently paid by the incumbent contractor. We recommend using the current rates for the base year, omitting the five-percent premium. Choctaw proposes annual rate increases in health and welfare of 15 percent, 12 percent, 12 percent, and 12 percent for option years one through four,

respectively. We believe the rate of annual increases for health and welfare to be excessive and recommend an annual increase of five percent for each option year.

Other items discussed in the notes to this report include uniform maintenance, FICA, Federal Unemployment Insurance, workers' compensation, and indirect costs. Choctaw also proposes other direct costs as a percentage of its proposed direct labor rates. We question this factor as other direct costs are reimbursed at a contractor's cost as provided in Federal Acquisition Regulation 52.232-7.

Choctaw's proposal also includes a fee, in the base year, of (b) (4) that it increases annually for field technicians. We were unable to determine why Choctaw proposed this amount. We have presented these fees on recommended rates for the purposes of comparability only.

Recommendation 1: We recommend that the Department's Bureau of Administration, Office of Logistics Management, Office of Acquisitions Management use the recommended rates set forth in Schedule A-2 to price delivery orders that Choctaw will perform under the proposed contract.

Accounting System

During the course of the review, Choctaw provided a copy of its financial statements. These statements disclose an account structure that does not differentiate between direct and indirect costs. As such, Choctaw's accounting system is not considered adequate for the accumulation of costs under flexibly priced contracts.

Choctaw's proposal has been prepared on a fixed rate per hour basis. That type of contract does not require an accounting system that differentiates between direct and indirect costs. Rather, billings are based on time as presented on signed and approved timesheets. To this extent, Choctaw's accounting system is considered to be minimally adequate for purposes of the contemplated contract.

Recommendation 2: We recommend that the Department's Bureau of Overseas Buildings Operations contracting officer's representative periodically review Choctaw's invoiced labor charges based on supporting timesheets and other relevant documents.

Leonard G. Birnbaum and Company, LLP



Leslie A. Leiper, Senior Partner

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(Insert Schedules A-1 and A-2. Hardcopy attached.)

Notes to Schedules A-1 and A-2

Note 1: Base Wage Rates

All wage rates pertain to the wage rates of the incumbent contractor, Garry Struthers Associates (Struthers). Prior to award of the contract, Choctaw Archiving Enterprise did not have any employees under the contract.

- a. The proposed base year wage rates are 105 percent of the rates currently paid by Struthers. We recommend using the current rates for the base year, omitting the five-percent premium.
- b. Exhibit B details the rates recommended based on the proposal. The schedule breaks out wage rates that could be supported by the current Struthers payroll register and all other proposed categories. For the proposed wage rates that could not be supported, we reviewed the rates and determined that they were reasonable.
- c. Annual increases in base wage rates for option periods one through four are five percent, four percent, four percent, and four percent, respectively. We find the annual wage increases to be reasonable.

Note 2: Health and Welfare

- a. The proposal sets forth annual rate increases in health and welfare of 15 percent, 12 percent, 12 percent, and 12 percent for option years one through four, respectively. Prior years' documentation for these costs could not be provided when requested. We find the rate of annual increases for health and welfare to be excessive and recommend an annual increase at a rate of five percent for each option year.
- b. Choctaw and Struthers have different base amounts that were used to calculate associated health and welfare costs. Within the proposal, however, there was no distinction between the associated costs for health and welfare. It appears as if all health and welfare costs were calculated using the figures from Struthers. Our recommended rates were calculated based on whether the position was designated as Choctaw or Struthers.
- c. Prior year's dental costs were inadvertently included within the base amounts for the calculation of Struthers' health and welfare costs. Our recommended rates eliminate the prior year's costs and use only the current year amounts.
- d. The proposal included 401(k) administration cost that amounted to \$7,600 annually (\$1,900 per quarter) as part of the Struthers' health and welfare calculation. It was estimated that 60 percent of the 59 projected participants would be related to the contract. Within the proposed health and welfare calculation, the total annual amount of \$7,600 was divided by the 59 projected participants, which equates to a per employee cost of \$128.81. In addition to this, the \$128.81 was multiplied by 60 percent to arrive at \$77.29 per person per year. The per employee cost of \$128.81 should not be reduced by the second 60 percent because such duplicated the original 60-percent factor.

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Furthermore, review of documentation provided in support of the 401(k) administration costs disclosed that the actual amount paid is \$1,712.50 per quarter and only 49 participants. We recommend using an annual amount of \$6,850 (\$1,712.50 x 4). Only 20 Struthers employees were listed within the proposal with 49 total participants. Therefore, the recommended annual base for 401(k) administration costs per employee is \$139.80 (\$6,850/49).

Note 3: Uniform Maintenance

The amounts listed under the uniform maintenance costs were based on an estimate of the number of uniform sets the average technician would use per month times the estimated cost per uniform set. On the basis of our review and the responses from Struthers, we consider the amounts proposed for uniform maintenance to be reasonable.

Note 4: FICA

The FICA increase per year was proposed at eight percent. We performed an analysis of the annual FICA increases from 2002 through 2006 and arrived at an average annual increase of 2.64 percent. We, therefore, consider the proposed eight percent FICA rate increase excessive and have recommended a five-percent increase for each subsequent option year.

Note 5: FUI

The Federal Unemployment Insurance amount is 0.8 percent, with a maximum deductible base amount of \$7,000 per year. The amounts within the proposal were calculated using eight percent rather than 0.8 percent. Our recommended rates use 0.8 percent.

Note 6: Workers' Compensation

Workers' compensation was proposed at 0.2177 percent of base wage rate, which was determined to be the rate paid by Struthers when it was the incumbent. The proposed factor was used to calculate the workers' compensation amounts for both Choctaw and Struthers. We obtained documentation for Choctaw's workers' compensation amounts and revised them for labor categories designated as Choctaw employees.

We found the 0.2177 percent rate used by Struthers to be reasonable and used them for the labor categories designated as Struthers' employees.

Increases to workers' compensation amounts were proposed at an annual rate of ten percent. We found this increase to be excessive and recommend an annual increase of five percent per year.

Note 7: Other Direct Costs

The proposal includes other direct costs as a percentage (b) (4)(b) (4) of the direct labor rate. We questioned this factor because other direct costs should be subject to direct reimbursement as provided in Federal Acquisition Regulation 52.232-7.

Note 8: Indirect Costs

General and administrative costs for Choctaw were proposed at a rate of (b) (4)(b) (4) of total direct labor. The proposed rate was based on expenses through July 2005 plus incomplete data for

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August 2005. To provide a consistent approach to development of the rate, we eliminated the August data, resulting in a recommended rate of (b) (4) .

Struthers did not have a federally approved indirect cost rate, but provided an overhead schedule reviewed by the Washington State Department of Transportation that determined the indirect rate to be (b) (4)(b) (4) of direct labor. We consider that rate to be acceptable for purposes of pricing the proposal.

Note 9: Profit & Fees

Profit and fees are a matter under the purview of the contracting officer. The proposal includes a fee, in the base year, of (b) (increased annually) for direct labor positions characterized as field technicians. We were unable to determine why Choctaw proposed this amount. We have presented these fees on recommended rates for the purposes of comparability only.

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